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No. OFFICE OF THE CLERK

In The
Supreme Court of the United States

HOWARD GREENBERG,
Petitioner,

v.

BEAR, STEARNS & CO.,
BEAR STEARNS & CO., INC.,
BEAR STEARNS SECURITIES CORP.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. What shall be the standard for reviewing cases arising under the federal securities acts in order to insure that rights under the securities laws are recognized in an arbitration?

2. If manifest disregard of the law is to be standard, was the Second Circuit correct in holding that the arbitrators had not manifestly disregarded the law by:

   a. not imputing knowledge of the admittedly fraudulent scheme to respondent Bear Stearns when the undisputed evidence showed that Bear Stearns management admitted reading the first and second sentences of the one applicable paragraph on page 2 of a prospectus but could not "recall" reading the third sentence which would have admittedly informed Bear Stearns of the fraudulent scheme?

   b. not imposing liability upon Bear Stearns pursuant to Section 12a(1) of the Securities Act of 1933 for failing to send a prospectus on an underwriting?

PARTIES TO THE PROCEEDING

Petitioner

Howard Greenberg

Petitioner is an individual and has no corporate affiliations.

Respondents

Bear Stearns & Co.

Bear Stearns & Co., Inc.

Bear Stearns Securities Corp.

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The opinions of the Second Circuit, 220 F.3d 22, and the district court are reprinted in the appendix commencing at page 1a.

JURISDICTION

Petitioner filed a petition in the United States District Court, Southern District of New York alleging that the arbitrators at the NASD had disregarded the securities laws to wit: the Securities Exchange Act of 1934, Section 10(b) and the Securities Act of 1933, Section 12(a)(1) and asking that the award be vacated. Jurisdiction existed because federal questions were raised by the petition pursuant to 28 U.S.C. § 1331.

The District Court denied petitioner's claims (Appendix, p. 15a) and petitioner appealed to the Court of Appeals for the Second Circuit. On August 7, 2000, the decision of the District Court was affirmed. The Second Circuit held that the federal courts had jurisdiction over the petition to vacate the arbitration award because federal jurisdiction will "lie if the ultimate disposition of the matter by the federal court 'necessarily depends on resolution of a substantial question of federal law'" and that the petitioner here complains "in good faith that the award was rendered in manifest disregard of federal law...." (pp. 7a and 9a of appendix).

Pursuant to Supreme Court Rule 13.1, this petition has been filed within 90 days of the Second Circuit Opinion and is, therefore, timely. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED IN THIS CASE

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b):

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5, 17 CFR § 240.10b-5:

> "It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud.
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact

necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any fact, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Securities Act of 1933, 15 U.S.C. 77e(b)(1):

"It shall be unlawful for any person, directly or indirectly --

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title."

Securities Exchange Act of 1933, Section 12(a)(1), 15 U.S.C. 77l(a)(1):

"(a) In general

Any person who --

(1) offers or sells a security in violation of section 77e of this title

* * *

shall be liable, subject to subsection (b) of this section, to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

17 CFR § 230.174(d):

"(d) If (1) the registration statement relates to the security of an issuer that is not subject, immediately prior to the time of filing the registration statement, to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, and (2) as of the offering date, the security is listed on a registered national securities exchange or authorized for inclusion in an electronic inter-dealer quotation system sponsored and governed by the rules of a registered securities association, no prospectus need be delivered after the expiration of twenty-five calendar days after the offering date. For purposes of this provision, the term *offering date* refers to the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public."

STATEMENT OF THE CASE

The undisputed evidence at the arbitration showed that a Bear Stearns' senior officer had read the first two sentences of the one applicable paragraph found at page 2 of a prospectus, but could not "recall" reading the third and fifth sentences of this one paragraph. The latter two sentences would have informed Bear Stearns beyond per adventure of doubt that Bear Stearns would be engaging in major fraud if it did the proposed underwriting. Petitioner claimed that knowledge of these sentences under these circumstances must be imputed to Bear Stearns. The Second Circuit's sole statement with respect to this read:

> "The petitioner argues that Bear Stearns should be deemed to have knowledge of the fraud because it had the necessary information before it, but it is by no means clear that the doctrine of imputed knowledge applies in this context." (Appendix p. 12a)

No cases, authority or reasoning were given to support this. The Second Circuit agreed that "knowing participation in a fraudulent scheme may render a participant liable under Section 10(b)" citing S.E.C. v. United States Environmental Inc., 155 F.3d 107, 111 (2d Cir. 1998), cert. den. sub nom. Romano v. S.E.C., 526 U.S. 1111, 119 S.Ct. 1755 (1999).

The undisputed facts showed the following: In August, 1996, Bear Stearns was requested by its introducing broker, Sterling Foster, for whom it cleared, to clear an underwriting of a most unusual sort in which Sterling Foster would sell 2.4 million shares of common stock of a company short after the initial offering by another firm of a separate 1.1 million shares and cover that 2.4 million short sale with stock from

inside selling shareholders. Concededly, the sale of stock from insiders constituted an underwriting. Thus, Bear Stearns knew in August, 1996 that there would be an underwriting in which stock of the inside shareholders would be sold immediately after the initial offering. Prompt covering was necessary in order to prevent Bear Stearns from being exposed to the unlimited risk of a short sale - that the price would rise above the sale price.

Bear Stearns' associate managing director requested and received a preliminary prospectus, which insofar as this matter is concerned was identical to the final prospectus. Page 2 of this preliminary prospectus contained the only paragraph relevant in the prospectus to the issuance of the inside selling shareholders' shares. This paragraph read as follows:

> "Also, the registration statement of which this Prospectus forms a part covers the offering of 2,400,000 shares of Common Stock, 2,000,000 Class A Warrants and 2,000,000 shares of Common Stock underlying Class A Warrants owned by certain affiliated and non-affiliated persons, hereinafter collectively referred to as the 'Selling Securityholders'. *The Company will not receive any of the proceeds on the sale of the securities by the Selling Securityholders*. The securities held by the Selling Securityholders may be sold commencing 12 months from the date of this Prospectus, subject to earlier release at the sole discretion of Patterson Travis, Inc., the representative (the 'Representative') of the underwriters of this offer (the 'Underwriters'). The Representative may release the securities

held by the Selling Securityholders at any time after all securities subject to the Over-Allotment Option have been sold or such option has expired. The Representative has no agreements or understandings with any of the Selling Securityholders with respect to release of the securities prior to the respective periods and has no present intention of releasing any or all of such securities prior to such periods." (emphasis added)

For clarity, the first three sentences have been done in different type.

This associate managing director admitted reading the first two sentences but couldn't recall reading the third sentence, which clearly says that these insider shares can be sold only after 12 months from the date of the prospectus (the initial offering). The fifth sentence says that there are "no agreements or understandings" to release the securities prior to that 12-month period. Thus, these statements (the lockup) directly contradicted the information represented to this associate managing director that there would be a sale of these securities immediately following the IPO.

This same one paragraph was delivered to the managing director and number 2 person at the Bear Stearns clearing operation and to a Bear Stearns' attorney who then prepared a separate guaranty agreement by Sterling Foster's President directly relating to this sale by the inside selling shareholders. But the number 2 managing director testified that he too couldn't "recall" anything about a lockup. The attorney, though requested to testify by petitioner, was not directed to testify by the arbitrators.

For this very fraud, the officers of Sterling Foster pled guilty to criminal securities fraud charges while this arbitration was pending and this fact was brought to the attention of the arbitrators.

Petitioner lost approximately half a million dollars on this fraudulent scheme under which Sterling Foster, clearing through Bear Stearns, distributed not the 1.1 million shares set forth in the prospectus, but three times that number or 3.5 million shares.

Sterling Foster paid $3.25 for these insider shares and sold to the public at prices ranging from $13.25 to over $15 per share for a 400% profit of approximately $24 million. The public lost approximately $50 million.

In addition, Bear Stearns, as the clearing agent for Sterling Foster, handled the payment to the insiders on behalf of Sterling Foster and mailed confirmations to Sterling Foster's customers. It is illegal under the Securities Act of 1933 to mail a confirmation within 25 days of an underwriting without also mailing to the customer a prospectus. Failure to do so allows rescission under Section 12(a)(1) of the Securities Act of 1933. No prospectus, however, was mailed to the customers.

The confirmations mailed by Bear Stearns stated that Sterling Foster made a market in the relevant stock. It did not disclose that in fact these transactions were part of an underwriting, not market making, nor that Sterling Foster made a 400% profit. Admittedly, Bear Stearns knew that this was an underwriting.

Thus, this fraudulent transaction was handled by Bear Stearns as though the securities laws did not exist. Yet, the

NASD arbitrators found in favor of Bear Stearns by dismissing at the end of petitioner's case. No reasons were stated.

The Court of Appeals held that such disregard of the securities acts did not constitute "manifest disregard" of the securities acts and, therefore, upheld the arbitrators.

REASONS FOR GRANTING THE WRIT

This Court in Shearson/American Express v. McMahon, 482 U.S. 220, 232 107 S.Ct. 2332, 2340 (1987), in holding that claims under the 1934 Securities Act could be arbitrated, held:

> "[A]lthough judicial scrutiny of arbitration awards necessarily is limited, such review is sufficient to insure that arbitrators comply with the requirements of the statute."

This is a promise which to date has not been kept. Today, the courts virtually always defer to the arbitrators even where the undisputed facts demonstrate violations of the securities acts as a matter of law. While some courts claim to review arbitration awards for "manifest disregard of the law", as one commentator stated:

> "The current formulation of manifest disregard of the law certainly lacks potency. Indeed, one must question whether it actually affords any protection beyond that provided in the arbitration statutes.... Manifest disregard of the law remains an illusive concept that can be understood better in terms of what it is not, rather than what it is." Levin, *The Role of*

Substantive Law in Business Arbitration and the Importance of Volition, 35 American Business L.J. 105, 149 (Fall 1997).

Indeed, the "manifest disregard" standard is applied by the courts not just to federal statutory claims, but to non-statutory cases, as well. See In re Carte Blanche (Singapore) PTE, Ltd., 888 F.2d 260, 267 (2d Cir. 1989). It is applied to those who have truly voluntarily agreed to arbitration and to those where industry-wide, and virtually universal practice, forces the weaker party into an industry-controlled arbitration. It is the latter case which prevails in the securities industry today. As Levin, supra, points out, it is unfair to treat those who truly voluntarily give up their rights to go to court for arbitration the same as those who did not and for the latter "there must be additional emphasis... on providing awards in accordance with law." (Id. at 174).

The Fifth Circuit does not even recognize the vague concept of manifest disregard. Gulf Coast Funds Workers Union v. Exxon Co., 991 F.2d 244 (5th Cir.) cert. den. 510 U.S. 965, 114 S.Ct. 441 (1993). The 11th Circuit applied it reluctantly only when respondent's attorney urged the arbitrators to disregard statutory law. Montes v. Shearson Lehman Bros., 128 F.3d 1456 (11th Cir. 1997). Indeed, one commentator compared the Second Circuit case of Halligan v. Piper Jaffe, Inc., 148 F.3d 197 (2d Cir. 1998) cert. den. 526 U.S. 1034, 119 S.Ct. 1286, to DiRussa v. Dean Witter Reynolds, Inc., 121 F.3d 818 (2d Cir. 1997) and noted that "the Halligan court did not clearly identify the law that it believed the arbitrators disregarded" and that Halligan involved a far more complex area of the law than DiRussa. Poser, *Judicial Review of Arbitration Awards: Manifest Disregard of the Law*, 64 Brooklyn L. Rev. 471, 479, Summer 1998. Yet, the court in DiRussa did not overturn the

arbitrators' refusal to award attorneys' fees to the victorious plaintiff under Title VII, to which the claimant was clearly entitled. This commentator called for a standard in which an award will be vacated "if the arbitrators deny a claimant statutory rights to which he or she is entitled." Poser, id. at 514.

Prior to Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 109 S.Ct. 1917 (1989) and Shearson/American Express v. McMahon, 482 U.S. 220, 107 S.Ct. 2332 (1987) pre-dispute agreements to arbitrate claims under the securities acts were invalid because the "power to vacate an award is limited" and "the provisions of the Securities Act... effectiveness in application is lessened in arbitration as compared to judicial proceedings." Wilko v. Swan, 346 U.S. 427, 435, 436, 74 S.Ct. 182 (1953).

> In overruling Wilko, this Court held:
> "Our conclusion is reinforced by our assessment that resort to the arbitration process does not inherently undermine any of the substantive rights afforded to petitioner under the Securities Act." Rodriguez de Quijas at 490 U.S. 485, 486.

But today, that confidence is in doubt and this Court has not ruled how in fact rights under the securities acts are to be protected. Protecting such rights is particularly important where the

> "NASD pool of arbitrators tends to be composed largely of retired persons and full-time professional arbitrators... who... may be subject to subtle pressures if a significant portion of their livelihood depends on that

> activity...[for] if an arbitrator decides too many cases adversely to brokerage firms, he or she is likely to be challenged peremptorily by brokerage firms in future cases." Poser, *Judicial Review of Arbitration Awards: Manifest Disregard of the Law*, 64 Brooklyn L.R. 471, 500, Summer 1998.

This is not simply a commentator's hypothetical fears, for a study by the Public Investors Arbitration Bar Association (PIABA *Evident Partiality Study [prelim]*) showed that even after Prudential-Bache Securities had been found by the SEC to have violated the anti-fraud statutes and had a fine of $10 million imposed by the SEC, $5 million by the NASD, $27.5 million by the states and agreed to a restitution fund of $336 million, in 29 out of 69 cases (43%) arbitrators from the Pacific Stock Exchange found against the investor in cases involving claims against Prudential-Bache arising out of the same fraudulent transactions. In all cases, the arbitrators who found against the investors were either professional arbitrators or were formerly associated with the securities industry.

Indeed, the securities industry itself recognizes that the SRO controlled arbitration forums such as the NASD favor the industry because when the courts allowed customer arbitrations to be brought before the American Arbitration Association through the so-called AMEX window, the American Stock Exchange immediately changed its constitution to prevent customers from using a non-SRO controlled forum. See Cowen & Co. v. Anderson, 76 N.Y.2d 318, 558 N.E.2d 27 (1990); Gregory and Schneider, *Securities Arbitration: A Need for Continued Reform*, 17 Nova L.R. 1223, 1243 (1993).

In such a setting, it is particularly important that the rights of investors under the Federal Securities Acts be protected by effective judicial review. As Gregory and Schneider, supra, stated:

> "If the Supreme Court has removed the investor's judicial remedy, the arbitration substituted for it should be fashioned in such a manner that the remedy is meaningful."
>
> x x x
>
> The fairness of our judicial systems is predicated on openness, impartiality and appellate review. Securities arbitration in its current repute fails in these important aspects." (id. at 1250).

The Connecticut Supreme Court stated:

> "Judicial approval of arbitration decisions that so egregiously depart from established law that they border on the irrational would undermine society's confidence in the legitimacy of the arbitration process." Garrity v. McCaskey, 612 A.2d 742, 747-48 (Conn. 1992).

Here, the undisputed facts demonstrate an irrational decision, upheld only by stretching the concept of rationality beyond the breaking point. Thus, the case at bar presents the general question as to what the standard of review should be for arbitration of securities act cases. The second question sets forth some of the precise issues of law ignored by the arbitrators under the securities acts.

In this case, the facts are simple and undisputed. Bear Stearns received a proposed prospectus which had one relevant paragraph on page 2. This paragraph and page was read, or sent to at least three people to read, who focused on that paragraph - an associate managing director, an attorney who drafted a special, guarantee agreement by Sterling Foster's President for the transaction, and the number 2 person at the clearing arm of Bear Stearns. Anyone reading the third sentence in that paragraph would immediately know that there was a massive fraud being perpetrated for that paragraph represented that there was a lockup of the 2.4 million shares of the inside selling security holders for one year whereas Bear Stearns knew and understood that those shares were to be sold immediately upon the initial public offering.

As the Second Circuit recognized,

> "Knowing participation in a fraudulent scheme may render a participant liable under § 10(b). See S.E.C. v. U.S. Envtl., Inc., 155 F.3d 107, 111 (2d Cir. 1998) cert. denied sub nom. Romano v. S.E.C., 119 S.Ct. 1755 (1999)." (Appendix p. 12a)

The associate managing director admitted to reading the first two sentences in that one paragraph. "Not recalling" to have read the third sentence of that one paragraph in these circumstances would be laughed out of court if this case had been before a federal court. Yet, that is precisely what managing director Keith Brigley admitted.

Virtually every circuit has held that knowledge of the facts contained in a document in one's hand should be imputed to that person or entity in circumstances far less

likely to have given such person actual knowledge than here where there was only one relevant paragraph upon which at least three senior officers focused. See e.g. Dodds v. Cigna Securities, Inc., 12 F.3d 346, 351 (2d Cir. 1993) cert. den. 511 U.S. 1019, 114 S.Ct. 1401, in which a woman with a 10th grade education who allegedly did not understand a prospectus was held not to be excused because "the means of knowledge are the same thing in effect as knowledge itself." Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1518 (10th Cir. 1983); DeBruyne v. Equitable Life Assurance Society of the United States, 920 F.2d 457, 466 n.18 (7th Cir. 1990); Koke v. Stifel, Nicolaus & Co., Inc., 620 F.2d 1340, 1344 (8th Cir. 1980); Myers v. Finkle, 950 F.2d 165, 167 (4th Cir. 1991). While those cases involved inexperienced claimants, that is no reason not to apply it to more knowledgeable insiders who are experienced in Wall Street matters. As the 7th Circuit held in S.E.C. v. Jakubowski, 150 F.3d 675, 681, 682 (7th Cir. 1998), in upholding summary judgment against the defendant:

> "Over and over again, we say that people claiming to be *victims* of securities fraud may not claim to rely on oral statements inconsistent with written documents (even tedious prospectuses) available to them... That is no less true when the person claiming ignorance of the writing made rather than received misstatements...."

Indeed, it is most perverse to apply the rule of imputed knowledge to some inexperienced, uneducated person and yet not to apply it to people, such as those at Bear Stearns, who were no mere clerks, but a lawyer and senior management. Yet, arbitrators, under the ruling of this case, are allowed to make such a perverse ruling.

Thus, applying this vague standard of "manifest disregard", the Second Circuit held, without citation or reasoning:

> "[I]t is by no means clear that the doctrine of imputed knowledge applies in this context." (Appendix p. 12a)

This Court should grant review to determine whether there should be applicable standards to vacate such an apparently irrational arbitration decision.

A similar indulgence was made with respect to the arbitrators' discretion as to the false confirmations. The confirmations sent failed to disclose either that the sales to petitioner were on an underwriting or the fact that a 400% profit had been made. Rather, the confirmations represented that a market-making transaction had taken place. Not disclosing critical facts in a confirmation such as the existence of an underwriting or excessive profit, here 400%, has been consistently held violative of Rule 10(b). Chasins v. Smith Barney & Co., Inc., 438 F.2d 1167 (2d Cir. 1970); Ettinger v. Merrill Lynch Pierce Finner and Smith, 835 F.2d 1031, 1036 (3d Cir. 1987); Grandon v. Merrill Lynch Pierce Finner and Smith, 147 F.3d 184, 189, 190 (2d Cir. 1998), holding:

> "There exists an implied representation that broker-dealers charge their customers securities prices that are reasonably related to the prices charged in an open and competitive market....A broker-dealer commits fraud (in violation of § 10(b) and Rule 10b-5) by charging customers excessive markups without proper disclosure."

Yet, the Second Circuit concluded that:

> "But the arbitrators could have concluded that the language was not actually false, since Sterling Foster, in fact, was a market maker in ML Direct securities at the time, although not for all transactions." (Appendix p. 13a)

In other words because Sterling Foster sometimes makes a market in that security, it is okay not to disclose the underwriting because those other transactions did not involve an underwriting. This excuse surely stretches the law beyond the breaking point.

As to the 400% profit, the court allowed the arbitrators to find that Bear Stearns was "unaware of an introducing broker's undisclosed and excessive profit" (Appendix p. 13a). But the undisputed facts are that one of Bear Stearns' managing directors was aware that Sterling Foster had sold shares with closing prices at $15.25 and $15.50, and that same managing director had received shares from the inside selling shareholders with directions to pay these inside selling shareholders certain fixed amounts. Simple arithmetic dividing the number of shares received into the amount paid would easily disclose the 400% profit (e.g. Special Equities delivered 1,000,080 shares with instructions to pay Special Equities $3,510,000, a little over $3 a share). Yet, the arbitrators were allowed to find that Bear Stearns was "unaware" and the Second Circuit did not discuss imputed knowledge requirements.

With respect to the Securities Act of 1933, there can be no dispute that 15 U.S.C. Section 77e(b)(1) and CFR § 230.174(d) make it unlawful to send a confirmation within the first 25 days of an underwriting without sending the

prospectus. Loss & Seligman, Fundamentals of Securities Regulation 3 Ed., p. 94 "[A] full prospectus must precede or accompany delivery [of securities] or confirmation, whichever first occurs...." Thus, sending a confirmation when Bear Stearns admittedly knew that there was an underwriting without sending a prospectus violated the basic rule of law of the Securities Act of 1933.

Section 12(a)(1) of the 1933 Securities Act, 15 U.S.C. Section 77l(a)(1) provides the remedy for such violation - rescission. The Second Circuit said with respect to this:

> [N]othing in the [clearing] agreement between Bear Stearns and Sterling Foster unambiguously shifted the burden of complying with this requirement onto Bear Stearns." (Appendix p. 13a)

One must ask, since Bear Stearns clearly had the obligation to send confirmations for Sterling Foster's trades, who was supposed to send the prospectus, if not Bear Stearns? Most importantly, if Bear Stearns felt that it was not required to send the prospectus, it had no right to knowingly send out illegal confirmations for those trades and blithely assume that some other person perhaps is sending out the prospectus. There was no evidence that Bear Stearns even asked who was sending out the prospectus for the underwriting when it should have known, as a matter of absolute, basic securities law, that for Bear Stearns to send confirmations without that prospectus was a violation of the Securities Act of 1933.

It is submitted that the arbitrators in effect allowed Bear Stearns to violate the Securities Acts of 1933 and 1934 with impunity. These blatant violations have been sanctioned by the courts as not being in manifest disregard of the law.

Under this standard, as applied, it is clear that the petitioner was not given the basic protections to which he was entitled under the securities acts.

The securities industry is one of the most important in the United States. Confidence in the securities industry is essential. To maintain such confidence, it is necessary to impose liability for violation of the laws governing the securities industry. See: Black, *The Core Institutions that Support Strong Securities Markets*, 55 Business Lawyer 1565, 1568, August, 2000. Today, most customer disputes must be handled in arbitration because of the virtually universal use of the pre-dispute agreement with all customers. Thus, it is necessary to maintain the effectiveness of the securities laws through arbitration.

As previously noted, the NASD certainly cannot be perceived as an unbiased forum because so many of its arbitrators continually sit and make their living off of arbitration and may not want to give decisions that might alienate brokerages, which may subject them to being peremptorily challenged in future cases. That the facts in this case raise serious questions of public concern is demonstrated by the numerous newspaper reports regarding this matter. See e.g. Gretchen Morgenson, Testimony Implicates Bear Stearns, N.Y. Times, Jan. 30, 1999, at B 1; Gary Weiss, Did Bear Stearns Ignore A Stock Swindle, Business Week, Nov. 23, 1998, at 162. And Mr. Michael Harrington, who, at the time of these events, was in charge of the Bear Stearns Clearing Division, has since been forced to resign from Bear Stearns over a matter not related to the Sterling Foster fraud and has been barred by the SEC from the securities industry.

Thus, if charges of fraud in violation of the securities acts are to be handled through industry appointed panels,

pursuant to pre-arbitration agreements, then this Court must determine a method for the courts to review arbitrations so that the basic rights under the securities laws are in fact protected.

CONCLUSION

This Court should, therefore, grant the writ of certiorari to determine the standards under which public customers of securities firms can receive the protections to which they are entitled under the securities acts.

Dated: New York, New York
October 25, 2000

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

[Filed August 7, 2000]

No. 99-9041

HOWARD GREENBERG,
Petitioner-Appellant,

v.

BEAR, STEARNS & CO.,
BEAR, STEARNS & CO., INC.,
and BEAR, STEARNS
SECURITIES CORP.,
Respondents-Appellees.

Before: OAKES, WALKER, and KEITH,* Circuit Judges.

Appeal from the judgment of the United States District Court for the Southern District of New York (John S. Martin, Jr., District Judge), denying the motion by the petitioner-appellant to vacate an arbitration award.

* The Honorable Damon J. Keith of the United States Court of Appeals for the Sixth Circuit, sitting by designation.

Affirmed.

OPINION

JOHN M. WALKER, JR., Circuit Judge:

Petitioner-appellant Howard Greenberg appeals from the August 25, 1999 judgment of the United States District Court for the Southern District of New York (John S. Martin, Jr., District Judge), denying his petition to vacate an arbitration award that dismissed his securities fraud claims against respondents-appellees Bear, Stearns & Co., Inc., and Bear, Stearns Securities Corp. (collectively, "Bear Stearns"). On appeal, Greenberg argues that the district court's judgment should be reversed and the arbitration award against him vacated because the arbitrators manifestly disregarded federal law in rendering the award. Bear Stearns responds that there was no basis for federal subject matter jurisdiction in this case and that, in any event, the arbitral award easily withstands review.

This appeal squarely presents the question of whether and under what circumstances federal courts have jurisdiction to hear motions to vacate arbitration awards. We conclude that the district court had jurisdiction in this case because Greenberg challenged the award primarily on the grounds of manifest disregard of federal law. Nevertheless, Greenberg has not met the very stringent burden of demonstrating the sort of manifest disregard required to vacate the award. Therefore, we affirm the judgment of the district court.

BACKGROUND

At the time of the events underlying Greenberg's claim, Bear Stearns (a "clearing broker") provided securities clearing services to Greenberg's primary broker, Sterling Foster (an "introducing broker"). According to Greenberg, Bear Stearns violated federal and state securities laws because it knew of and participated in a fraudulent scheme perpetrated by Sterling Foster; sent false and misleading confirmations in connection with this scheme; and failed to send out a required prospectus. We briefly discuss the facts and allegations pertinent to the appeal.

In 1996, Sterling Foster organized the initial public offering ("IPO") for a company called ML Direct. Under an agreement between Bear Stearns and Sterling Foster, the latter requested permission from the former to underwrite this sale. According to Sterling Foster's plan, ML Direct would make a public sale of 1.1 million shares, and Sterling Foster would sell short an additional 2.3 million shares, to be covered by shares it would obtain from existing shareholders. This scheme was fraudulent, alleged the plaintiff, because the prospectus distributed to purchasers of ML Direct stock stated that shares from the selling shareholders were subject to a lock-up agreement for 12 months and that there were "no agreements or understandings . . . with respect to release of the securities prior to [this time]." Bear Stearns employees admitted having seen the prospectus, but did not recall reading the sentences about the lock-up. Bear Stearns agreed to clear the transaction.

In September 1996, the IPO and stock sales proceeded as planned. Sterling Foster allegedly reaped an enormous

profit at the expense of the selling shareholders by selling shares short and purchasing shares from those shareholders at a significantly lower price. Bear Stearns sent out confirmations to purchasers of ML Direct stock that stated: "Your broker makes a market in this security and acted as principal." The confirmations did not disclose Sterling Foster's short sales or its large profit, nor was a prospectus sent to those who purchased shares.

In May 1997, the petitioner filed a claim with the National Association of Security Dealers ("NASD") against Bear Stearns alleging, among other things, fraud and market manipulation in connection with Bear Stearns's provision of securities clearing services to Sterling Foster. A panel of three arbitrators heard arguments and testimony through extensive briefing and seven days of hearings. The arbitrators first dismissed Greenberg's claim based on Bear Stearns's purported failure to send him a prospectus and thereafter dismissed his remaining claims. On March 9, 1999, the arbitrators issued a written award confirming their decision to dismiss.

On January 18, 1999, Greenberg moved in federal district court to vacate the award on the basis that it "violated public policy and manifestly disregarded the law." In an opinion and award dated August 23, 1999, the district court denied the motion on the grounds that the petitioner had failed to demonstrate manifest disregard of the law in the arbitrators' treatment of his claims. This appeal followed.

DISCUSSION

I. Federal Jurisdiction

The principal question presented in this appeal is whether the district court had federal question jurisdiction over Greenberg's motion to vacate the arbitration award. Jurisdiction would plainly lie if, among other things, the parties were diverse, see 28 U.S.C. § 1332, the claim arose in admiralty, see 28 U.S.C. § 1333, or the dispute concerned the interpretation of a collective bargaining agreement, see 29 U.S.C. § 185(a). Cf. Drexel Burnham Lambert, Inc. v. Valenzuela Bock, 696 F. Supp. 957, 964-65 (S.D.N.Y. 1988) (Leval, J.) (listing some circumstances under which federal courts plainly have jurisdiction to hear a petition to compel arbitration). However, we must decide whether and under what circumstances a federal court may entertain a motion to vacate an award where, as in this case, alternative bases for jurisdiction are absent. We conclude that: (1) the fact that the arbitration itself concerns issues of federal law does not, on its own, confer subject matter jurisdiction on a federal district court to review the award; but (2) federal jurisdiction may lie where the petitioner seeks to vacate the award primarily on the ground of manifest disregard of federal law.

Federal courts have jurisdiction over "all civil actions arising under the . . . laws . . . of the United States." 28 U.S.C. § 1331. Federal question jurisdiction exists where a well-pleaded complaint "establishes either that federal law creates the cause of action or that the plaintiff's right to relief necessarily depends on resolution of a substantial question of federal law." Franchise Tax Bd. v. Construction Laborers Vacation Trust, 463 U.S. 1, 27-28 (1983).

Federal law plainly does not create the cause of action in this case. Greenberg filed his petition under § 10 of the Federal Arbitration Act ("FAA"), which authorizes "the United States court in and for the district wherein the [arbitration] award was made" to "make an order vacating the award" under certain circumstances. 9 U.S.C. § 10(a). However, it is well-settled that the FAA does not confer subject matter jurisdiction on the federal courts even though it creates federal substantive law. See Southland Corp. v. Keating, 465 U.S. 1, 16 n.9 (1984); Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25 n.32 (1983). Therefore, federal question jurisdiction does not arise simply because a petitioner brings a claim under § 10 of the FAA; there must be "an independent basis of jurisdiction" before district courts may entertain petitions to vacate. Harry Hoffman Printing, Inc. v. Graphic Communications, Int'l Union, Local 261, 912 F.2d 608, 611 (2d Cir. 1990).

Simply raising federal-law claims in the underlying arbitration is insufficient to supply this "independent basis." In the context of a motion to compel arbitration under § 4 of the FAA, see 9 U.S.C. § 4, we have specifically held that there is no federal subject matter jurisdiction "merely because the underlying claim raises a federal question." Westmoreland Capital Corp. v. Findlay, 100 F.3d 263, 268 (2d Cir. 1996). Petitions to compel arbitration "must be brought in state court unless some other basis for federal jurisdiction exists, such as diversity of citizenship or assertion of a claim in admiralty." Id. Language in § 4 seemingly authorizing the federal courts to hear such petitions "is not intended to confer jurisdiction, but should instead be read as a response to the antiquated common law principle that an agreement to arbitrate would oust the federal courts of

jurisdiction." Id. at 267-68 (citing Valenzuela Bock, 696 F. Supp. at 961-62).

The holding in Westmoreland logically extends to motions to vacate an arbitration award under § 10 of FAA. Indeed, we implied as much in Westmoreland itself, see 100 F.3d at 268, and other courts have explicitly so held, see, e.g., Kasap v. Folger Nolan Fleming & Douglas, Inc., 166 F.3d 1243, 1247 (D.C. Cir. 1999); Ford v. Hamilton Invests., Inc., 29 F.3d 255, 257-58 (6th Cir. 1994); Lipton v. Shearson, 934 F. Supp. 638, 639 (S.D.N.Y. 1996); Magninelli v. Smith Barney, Inc., No. 98 Civ. 8986, 1999 WL 615096, at *1 (S.D.N.Y. Aug. 12, 1999). As with a motion under § 4, the only federal rights that a motion under § 10 necessarily implicates are those created by the FAA itself, which rights do not give rise to federal question jurisdiction. In both contexts, there is no necessary link between the requested relief and the character of the underlying dispute. For example, a petition to compel arbitration because the dispute falls within the scope of an arbitration clause, or to vacate an award because the arbitrators exceeded their powers under that clause, will turn on the interpretation of the clause, regardless of whether the actual dispute implicates any federal laws. Accordingly, the fact that the arbitration concerns issues of federal law does not, standing alone, confer subject matter jurisdiction on a federal district court to review the arbitral award.

Nevertheless, federal jurisdiction may still lie if the ultimate disposition of the matter by the federal court "necessarily depends on resolution of a substantial question of federal law." Barbara v. New York Stock Exch., Inc., 99 F.3d 49, 54 (2d Cir. 1996) (internal quotation marks omitted).

Thus we must decide whether the petition in this case to vacate an arbitral award presents a substantial question of federal law.

"[I]n determining federal question jurisdiction, courts must make principled, pragmatic distinctions, engaging in a selective process which picks the substantial causes out of the web and lays the other ones aside." Id. (internal quotation marks omitted). "[E]xamining only those allegations which are properly raised in a well-pleaded complaint, we look to the nature of the federal question raised in the claim to see if it is sufficiently substantial to warrant federal jurisdiction." Greenblatt v. Delta Plumbing & Heating Corp., 68 F.3d 561, 570 (2d Cir. 1995) (internal quotation marks omitted). The greater the federal interest at stake, the more likely it is that federal jurisdiction will be found. See West 14th St. Commercial Corp. v. 5 West 14th Owners Corp., 815 F.2d 188, 193 (2d Cir. 1987) (citing Merrell Dow Pharmaceuticals, Inc. v. Thompson, 478 U.S. 804, 814 n.12 (1986)).

In our view, under these standards, whether or not a petition to vacate under § 10 raises a substantial federal question turns on the ground for the petitioner's challenge to the award. The FAA and federal case law supply various bases for review of an arbitral award. Section 10 itself lists several grounds, including fraud in procuring the award; corruption, partiality, or prejudicial misconduct on the part of the arbitrators; abuse of power; and failure to render "a mutual, final, and definite award." 9 U.S.C. § 10(a). Judicial interpretation has added additional grounds, such that awards may be vacated under limited circumstances where the arbitrators manifestly disregarded the law, see DiRussa v. Dean Witter Reynolds Inc., 121 F.3d 818, 821 (2d Cir.

1997), or where enforcement would violate a "well defined and dominant public policy," IBEW Local 97 v. Niagara Mohawk Power Corp., 143 F.3d 704, 717 (2d Cir. 1998) (internal quotation marks omitted).

We hold that where, as here, the petitioner complains principally and in good faith that the award was rendered in manifest disregard of federal law, a substantial federal question is presented and the federal courts have jurisdiction to entertain the petition. In contrast to grounds of review that concern the arbitration process itself -- such as corruption or abuse of power -- review for manifest disregard of federal law necessarily requires the reviewing court to do two things: first, determine what the federal law is, and second, determine whether the arbitrator's decision manifestly disregarded that law. This process so immerses the federal court in questions of federal law and their proper application that federal question subject matter jurisdiction is present.

Where the arbitrators' alleged manifest disregard of federal law forms a key part of the petitioner's complaint about the award, the federal questions thereby presented are substantial enough to support federal jurisdiction. First, although review for manifest disregard is "severely limited," DiRussa, 121 F.3d at 821, if engaging in such review is essentially all that is required of the reviewing court, it is plain that federal questions will predominate. Second, there is a clear federal interest in resolving these questions. While federal claims may appropriately be resolved through arbitration, the federal courts have a strong interest in ensuring that arbitrators interpret and apply federal law properly, even if within a wide range of tolerance. Cf. Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220, 232

(1987) ("[A]lthough judicial scrutiny of arbitration awards necessarily is limited, such review is sufficient to ensure that arbitrators comply with the requirements of the statute."). Indeed, as Judge Leval observed, this interest "would seem to be far greater" than the federal interest implicated by a petition to compel arbitration under § 4 -- that is, the "interest in seeing that the claims be arbitrated" in the first place. Valenzuela Bock, 696 F. Supp. at 963.

We note that, by and large, the rulings of other courts are not inconsistent. Many courts have found the simple presence of federal claims in the arbitration itself insufficient as an independent basis for federal jurisdiction. These cases, however, generally did not involve a petition to vacate on the grounds of manifest disregard of federal law in the arbitrators' resolution of the underlying federal claims. But see Manginelli, 1999 WL 615096, at *2 (holding that the "limited application and interpretation of federal law" required to rule on a petition to vacate an award on the grounds of manifest disregard is insufficient to "provide an independent basis for federal jurisdiction"). Instead, the petitioners challenged arbitration awards on grounds that plainly did not require resolution of a uniquely federal issue, including perjury, see Kasap, 166 F.3d at 1245; "alleged misdeeds of the arbitrators," Baltin v. Alaron Trading Corp., 128 F.3d 1466, 1472 (11th Cir. 1997); "fraud, corruption, undue means, evident partiality, and failure to consider pertinent and material evidence," Minor v. Prudential Sec., Inc., 94 F.3d 1103, 1105-06 (7th Cir. 1996); and manifest disregard of state law, see Ford, 29 F.3d at 258; Lipton, 934 F. Supp. at 639. The Seventh Circuit acknowledged that the federal courts might have jurisdiction if the motion to vacate involved, on its face, "the resolution of [the petitioner's] federal claims or

some question of federal law." Minor, 94 F.3d at 1106. But see Kasap, 166 F.3d at 1247 (suggesting that review for fraud under § 10 implicates federal law but that this is insufficient to support federal jurisdiction). Where the petitioner seeks vacatur chiefly on the ground of manifest disregard of federal law, a federal question is plainly presented.

In this case, if it were not for the claim that vacatur is warranted because federal law was manifestly disregarded, we would find no jurisdiction. The simple fact that the underlying arbitration implicated federal questions would not be enough. But because the petition alleges primarily that the award was rendered in manifest disregard of the federal laws underpinning these claims, federal question jurisdiction is present.

Accordingly, the district court had jurisdiction to consider Greenberg's petition, and this appeal is properly before us. We turn now to the merits.

II. Review of the Award for Manifest Disregard of the Law

The district court held that the petitioner had failed to demonstrate that the arbitral award was rendered in manifest disregard of the law. Review for manifest disregard is "severely limited." DiRussa, 121 F.3d at 821. In order to vacate an award on these grounds, a reviewing court must find "both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case." Id. (internal quotation marks and alterations omitted). The party seeking

vacatur of the award bears the burden of showing manifest disregard under these standards. See Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp., 103 F.3d 9, 12 (2d Cir. 1997). A district court's application of the manifest disregard standard is a legal determination that we review de novo. See id.

The petitioner has failed to meet this very stringent burden with respect to any of his claims against Bear Stearns. First, Greenberg argues that the arbitrators manifestly disregarded federal law in denying his claim that Bear Stearns knew about Sterling Foster's fraudulent scheme and is therefore liable under § 10(b) of the Securities Exchange Act. Knowing participation in a fraudulent scheme may render a participant liable under § 10(b). See S.E.C. v. United States Envtl., Inc., 155 F.3d 107, 111 (2d Cir. 1998), cert. denied sub nom. Romano v. S.E.C., 119 S. Ct. 1755 (1999). In this case, however, Bear Stearns employees testified that they did not know about Sterling Foster's fraud, and thus the arbitrators could reasonably have concluded that Bear Stearns lacked the knowledge required for § 10(b) liability. The petitioner argues that Bear Stearns should be deemed to have knowledge of the fraud because it had the necessary information before it, but it is by no means clear that the doctrine of imputed knowledge applies in this context.

Second, according to Greenberg, Bear Stearns violated federal securities law by sending knowingly false confirmations. The confirmations were allegedly misleading because, while they made certain disclosures, they failed to reveal that the transaction was an underwriting, not a market sale, and that Sterling Foster was reaping a 400% profit from the scheme. But the arbitrators could have concluded that the

language was not actually false, since Sterling Foster, in fact, was a market maker in ML Direct securities at the time, although not for all transactions. In addition, there is no well-settled law imposing a duty upon a clearing broker, who is unaware of an introducing broker's undisclosed and excessive profit, to inquire into the matter and then inform the latter's customers of such self-dealing.

Third, Greenberg contends that Bear Stearns failed to comply with 17 C.F.R. § 230.174, which requires delivery of a prospectus in connection with the sale of newly issued securities. But the regulation imposes this requirement only on underwriters and dealers, not on clearing brokers, and nothing in the agreement between Bear Stearns and Sterling Foster unambiguously shifted the burden of complying with this requirement onto Bear Stearns.

Finally, Greenberg asserts that Bear Stearns should be held liable as an aider and abetter under New York law because it participated in the fraudulent scheme and provided substantial assistance to Sterling Foster. See S & K Sales Co. v. Nike, Inc., 816 F.2d 843, 847-48 (2d Cir. 1987). However, there was ample basis for the arbitrators to conclude that Bear Stearns's participation was insufficient to constitute substantial assistance. "[T]he simple providing of normal clearing services to a primary broker who is acting in violation of the law does not make out a case of aiding and abetting against the clearing broker." Stander v. Financial Clearing & Servs. Corp., 730 F. Supp. 1282, 1286 (S.D.N.Y. 1990); cf. Edwards & Hanly v. Wells Fargo Sec. Clearance Corp., 602 F.2d 478, 484 (2d Cir. 1979) (clearing brokers owe no separate duty to customers of an introducing broker).

In sum, the arbitrators did not ignore or refuse to apply well-defined and clearly applicable law in rejecting any of the appellant's claims in such a way that would amount to manifest disregard.

CONCLUSION

For the foregoing reasons, we hold that: (1) where, as here, a § 10 petitioner complains principally and in good faith that an arbitration award was rendered in manifest disregard of federal law, the federal courts have jurisdiction to entertain the petition; and (2) the district court in this case properly rejected the petitioner's claim for failure to demonstrate that the arbitrators had manifestly disregarded the law in their treatment of his securities claims. We have considered the petitioner's other arguments and find them to be without merit. Accordingly, we affirm the judgment of the district court.

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[Dated August 23, 1999]

No. 99 Civ. 358 (JSM)

HOWARD GREENBERG ,
Petitioner,

v.

BEAR STEARNS & CO., INC.
and BEAR STEARNS
SECURITIES CORP.,
Respondents.

MEMORANDUM OPINION AND ORDER

JOHN S. MARTIN, Jr., District Judge:

This case is before the Court on a petition to vacate an arbitral award dismissing all of petitioner's claims.

Bear Stearns served as the clearing broker for Sterling Foster, a now-defunct brokerage house whose President, Adam Lieberman, pled guilty in this District to securities fraud charges. One of the fraud schemes Sterling Foster carried out involved the fraudulent sale of shares of ML

Direct, a company whose stock offering Sterling Foster underwrote. Sterling Foster sold shares of ML Direct short and then released into the market ML Direct shares that were supposed to be "locked up." The flood of ML Direct shares on the market caused the share price to drop, and petitioner Howard Greenberg, who bought 29,000 shares in September 1996, lost the value of his investment.

An NASD arbitration panel heard petitioner's claim over seven days and dismissed all his claims at the end of the arbitration. Petitioner seeks to have the arbitral award overturned because it is in manifest disregard of the law. Wilko v. Swan, 346 U.S. 427, 436-437, 74 S.Ct. 182, 187 (1953) rev'd on other grounds Rodriguez de Quijas v. Shearson/American Express Inc., 490 U.S. 477, 109 S.Ct. 1917 (1989); Carte Blanche (Singapore) Pte., Ltd. v. Carte Blanche Int'l, Ltd., 888 F.2d 260, 265 (2d Cir. 1989).

Review of an arbitral decision for manifest disregard of the law is "severely limited." DiRussa v. Dean Witter Reynolds Inc., 121 F.3d 818, 821 (2d Cir. 1997) (citations omitted). To modify or vacate an award, a court must find both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit and clearly applicable to the case. Id. (citations and quotations omitted). A court may also modify or vacate an award if there is "strong evidence" contrary to the findings of the panel and the panel has not provided an explanation of its decision. Halligan v. Piper Jafray Inc., 148 F.3d 197, 204 (2d Cir. 1998).

Petitioner first claims that the arbitrators incorrectly denied his claims that Bear Stearns knew, as a matter of fact and law, of the premature sale of restricted ML Direct securities. The panel heard testimony from the three Bear Stearns employees who possessed sections of the ML Direct prospectus prior to the sales in question. Each testified that they did not know that certain ML Direct shares were subject to a lock-up provision. The arbitrators credited the testimony of these employees and rejected Greenberg's contention that Bear Stearns knew but ignored the premature sale of restricted securities. The Court will not second-guess the credibility findings of the arbitral panel and will not disturb the panel's findings that Bear Stearns lacked knowledge of Sterling Foster's fraud scheme.

Petitioner's legal argument rests upon cases that impose a "duty to read" upon parties to a contract. Dodds v. Cigna Securities, 12 F.3d 346, 351 (2d. Cir. 1993); see Wood v. Carpenter, 101 U.S. 135, 143 (1879) ("The means of knowledge are the same thing as knowledge itself."). While it is true that in some circumstances the law will preclude a party from asserting that he was unaware of the terms of a contract he signed or a document he read, there is no general rule that one who may once have had possession of a document can not thereafter deny knowledge of something contained therein. The concept of imputed knowledge seeking to avoid the obligation of a contract by denying knowledge of its terms at the time it was signed, or situations where a party asserting a claim of fraud denies knowledge facts set forth in a document that he was given to review in the course of the transaction at issue. The "duty to read" cases did not require the arbitrators to find that the parties engaged in fraudulent conduct by applying an irrebuttable presumption that a party

must have known a fact contained in a document he once possessed. Accordingly, the proposition that Bear Stearns knew, as a matter of law, that Sterling Foster was engaged in fraud is not a governing legal principle that the panel failed to apply. Halligan, 148 F.3d at 202.

Petitioner's second contention is that Bear Stearns participated in the Sterling Foster fraud scheme through its underwriting work. Petitioner submitted the following evidence to support his claim of collusion between Bear Stearns and Sterling Foster: Richard Harriton, a high ranking Bear Stearns official, personally granted Sterling Foster permission to clear its sales of ML Direct securities through Bear Stearns; Harriton required Sterling Foster to deposit $3 million with Bear Stearns to cover its trades and required Sterling Foster's chairman Adam Lieberman to assume personal liability for any money owed Bear Stearns as a result of clearing activities; Bear Stearns employees expressed concern amongst themselves regarding their credit exposure in clearing ML Direct shares and Bear Stearns made a profit on clearing the trades.

The arbitrator's decision that this evidence is insufficient to establish Bear Stearns' complicity in the Sterling Foster scheme does not reflect a manifest disregard of the evidence or the law.

First, clearing brokers do not owe a separate duty to the customers of an introducing broker. Edwards and Hanly v. Wells Fargo Securities, 602 F.2d 478, 484 (2d Cir. 1979); Dillon v. Militano, 731 F.Supp. 634, 636 (S.D.N.Y. 1990). Petitioner's recourse for Sterling Foster's fraud lies with Sterling Foster, not the clearing house.

Second, the arbitrators heard evidence that the conduct complained of is within the normal course of business for a clearing house when clearing transactions for an underwriting introducing broker. The evidence presented to the arbitrators is not so biased as to allow the Court to vacate the arbitrator's own assessment of this evidence.

Lastly, the conduct described to the arbitrators was not fraudulent. See Ross v. Bolton, 1989 WL 80428 aff'd 904 F.2d 819, 824 (2d Cir. 1990).

Petitioner also asserted to the panel that Bear Stearns knowingly participated in Sterling Foster's breach of fiduciary duties in violation of New York law. See S & K Sales v. Nike Inc., 816 F.2d 843, 847-848 (2d Cir. 1987). As discussed above, the panel apparently declined to credit petitioner's contention that Bear Stearns knew of the Sterling Foster fraud. The panel's obvious conclusion that Bear Stearns employees did not have scienter as to the 10(b) claims also negates petitioner's state law claim of knowing collusion.

Petitioner also complains that the arbitrators neglected the law and evidence regarding Bear Stearns's obligation to send prospectuses in accordance with Rule 174 of the Securities Act of 1933. Petitioner cannot contest that 17 C.F.R. § 230.174 imposes upon a dealer or underwriter the obligation to send a prospectus under certain circumstances. Bear Stearns is not liable for any failure to send a prospectus to petitioner absent evidence that Bear Stearns assumed responsibility for this underwriting function. The arbitrators reviewed the agreement between Bear Stearns and Sterling Foster and found insufficient evidence to impose this obligation upon Bear Stearns. Petitioner has failed to

establish that this decision was in violation of law or against the weight of the evidence presented to the panel. Rather, petitioner asks the Court to review the panel's legal findings de novo and to substitute its interpretation of the evidence for that of the panel. Such review, however, would be beyond the scope of review of an arbitral decision.

Lastly, petitioner objects to the panel's finding that the legend Bear Stearns printed on trade confirmation tickets was neither false, misleading nor in violation of SEC Rule 10b-10. see 17 C.F.R. § 240.10b-10(a) (2).

The trade confirmation tickets petitioner received stated "Your broker makes a [market] in this security, and acted as principal." See Pet. Exh. L. Petitioner first claims that the legend is misleading because it implies that he purchased ML Direct securities in a market transaction and not from an underwriter. While this may be a reasonable inference, the panel apparently decided that the legend was not misleading because it was true. The fact that an introducing broker makes a market in a given security does not lead to the sole conclusion that every transaction with that broker is a market transaction.

Petitioner's second point concerning trade confirmations concerns the 400% profit Sterling Foster made on fraudulent sales of ML Direct stock. Petitioner relies on S.E.C. v. First Jersey Securities, 101 F.3d 1450, 1472 (2d Cir. 1996) to suggest that Bear Stearns owed him a duty to inform him of Sterling Foster's outrageous profit. This argument is without merit because the defendant in First Jersey was a broker-dealer that manipulated customers by misleading its own sales force. The legal duty of a broker-

dealer to notify purchasers of its own self dealing cannot be imposed upon Bear Stearns, a clearing broker that the panel found was unaware of Sterling Foster's fraud.

For the foregoing reasons the petition to overturn the arbitral award is denied. The Clerk of Court is instructed to close this case.

SO ORDERED.

Dated: New York, New York
August 23, 1999

/s/_____
JOHN S. MARTIN, JR., U.S.D.J.